IT 07-0018-GIL 04/17/2007 CREDITS – FOREIGN TAX

General Information Letter: Computation of income double-taxed by Illinois and STATE explained.

April 17, 2007

Dear:

This is in response to your letter dated June 21, 2006, which was forwarded to me for consideration. I apologize for the delay in responding. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www. tax.illinois.gov.

In your letter you have stated the following:

> In reply to your notice dated June 15, 2006, a copy of which is enclosed, please be advised we do not agree with your recommended changes resulting in additional tax due in the amount of $7,479.71.
>
> The Illinois Department of Revenue adjusted line 19, credit for taxes paid to another stated. The method used was incorrect. The taxpayer paid alternative minimum tax to the state of STATE and the amount of AMT income should be included in the taxes that are deemed to be double taxed. We have enclosed a copy of our STATE income tax return indicating the taxpayer did pay alternative minimum tax to the state of STATE. Please refer to schedule MT.
>
> In accordance with the instructions for Schedule CR this income is to be included as double taxed. Therefore, we believe the adjustments you recommended are incorrect and your invoice in the amount of $7,479.71 should be cancelled.

Response

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601) provides, in part:

> The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.

The Department's regulation at 86 Ill. Adm. Code Section 100.2197(b)(4) provides that, in order to compute the "base income subject to tax by both such other state or states and by this State" (referred to as "double-taxed income"), a taxpayer should take into account only those items of

income taxed by both states and should deduct only those expenditures for which both states allow a deduction. Section 100.2197(b)(4)(F) provides:

> Some states impose an alternative minimum tax similar to the tax imposed by IRC section 55, under which a taxpayer computes a regular taxable income and also computes an alternative minimum taxable income by reducing some exclusions or deductions, and eliminating other exclusions and deductions entirely. The taxpayer applies different rate structures to regular taxable income and to alternative minimum taxable income, and is liable for the higher of the two taxes so computed. An item of income included in a state's alternative minimum taxable income but not in the regular taxable income of that state is not included in base income subject to tax in that state unless the taxpayer is actually liable for alternative minimum tax in that state.

Section 100.2197(b)(4)(G) provides:

> Some states compute the tax liability of a nonresident by first computing the tax on all income of the nonresident from whatever source derived, and then multiplying the resulting amount by a percentage equal to instate sources of income divided by total sources of income or by allowing a credit based on the percentage of total income from sources outside the state. Other states determine the tax base of a nonresident by computing the tax base as if the person were a resident and multiplying the result by the percentage equal to in-state sources of income divided by total sources of income. The use of either of these methods of computing tax does not mean that income from all sources is included in double-taxed income. See Comptroller of the Treasury v. Hickey, 114 Md. App. 388, 689 A.2d 1316 (1997); Chin v. Director, Division of Taxation, 14 N.J. Tax 304 (T.C. N.J. 1994). When a state uses either of these methods of computation, double-taxed income shall be the base income of the taxpayer from all sources subject to tax in that state, as computed in accordance with the rest of this subsection (b)(4), multiplied by the percentage of income from sources in that state, as computed under that state's law; provided, however, that no compensation paid in Illinois under IITA Section 304(a)(2)(B) shall be treated as income from sources in that state in computing such percentage.

Detailed application of these rules can be found in Publication 111, Illinois Schedule CR Comparison Formulas for Individuals. The taxpayers' credit was properly computed in accordance with that publication.

The STATE Form 1NPR filed by the taxpayers for 2005 shows income from all sources of $976,319, and income from STATE sources of $604,962, so that 61.96% of the taxpayers' income was from STATE sources. In computing their income subject to alternative minimum tax, the taxpayers reduced the depreciation expense deduction by $779 (line 17 of the federal Form 6251), which means that $779 in depreciation deductions were taken in computing Illinois base income that were not allowed in computing income subject to STATE alternative minimum tax and should not be deducted in computing double-taxed income. This is the only difference between the computation of income subject to regular STATE income tax and the alternative minimum tax that needs to be taken into account in computing double-taxed income.

The taxpayers' double-taxed income is therefore $605,410, which is the $976,319 in income from all sources on their STATE return, increased by the $779 in depreciation expense adjustments, with the total multiplied by the 61.96% of income that is from STATE sources.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax